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Whirlpool Corp. (WHR)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Whirlpool Corporation's Third Quarter 2022 Earnings Release Call. Today's call is being recorded. For opening remarks and introductions, I would like to turn the call over to Senior Director of Investor Relations, Corey Thomas.

Willyam K. Thomas

Senior Director-Investor Relations, Whirlpool Corp.

Thank you, and welcome to our third quarter conference call. Joining me today are Marc Bitzer, our Chairman and Chief Executive Officer; Jim Peters, our Chief Financial Officer; and Joe Liotine, our Chief Operating Officer. Our remarks today track with a presentation available on the Investors section of our website at WhirlpoolCorp.com. Before we begin, I want to remind you that as we conduct this call, we'll be making forward-looking statements to assist you in better understanding Whirlpool Corporation's future expectations. Our actual results could differ materially from these statements due to many factors discussed in our latest 10-K, 10-Q and other periodic reports. We also want to remind you that today's presentation includes non-GAAP measures. We believe these measures are important indicators of our operations as they exclude items that may not be indicative of results from our ongoing business operations. We also think the adjusted measures will provide you with a better baseline for analyzing trends in our ongoing business operations.

Listeners are directed to the supplemental information package posted on the Investor Relations section of our website for the reconciliation of non-GAAP items to the most directly comparable GAAP measures. We have also provided additional information related to inventory, demand and fixed costs that will now be regularly provided or updated in future quarterly earnings materials. At this time, all participants are in listen only mode. Following the prepared remarks, the call will be open for analysts' questions. As a reminder, we ask that participants ask no more than 2 questions.

And with that, I'll turn the call over to Marc.

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

Thanks, Korey, and welcome, everyone, to our third quarter earnings call. As you can see from our agenda on slide 4, we plan to discuss today more than just our third quarter results. We are operating in unprecedented times, and we do feel it is necessary and helpful for investors to broaden the time horizon of today's call beyond Q3 and take a step back to reinforce our long-term strategy as well as our perspective on favorable mid and long-term consumer demand trends.

In the first agenda item, we will discuss the Q3 results in detail. You will see that short-term consumer sentiment and consumer demand are clearly reflective of recessionary environment. While at the same time, input costs, which you would expect to come down in a recessionary environment are still elevated. Needless to say that this combination impacted our Q3 negatively.

In the second agenda item, we will show you that Whirlpool has a strong track record of successfully managing through these cycles. We're laser-focused on ensuring we have the strongest business irrespective of rapid changes in the macro environment. We have and we will continue to take action early and decisively, and we have done so again this quarter. Beyond the current recessionary challenges, we strongly believe in the favorable mid- and long-term demand tailwinds, in particular in North America. And our business is very well positioned to win in this attractive post-recession setup. We will cover this in the third agenda item.

And finally, in the fourth agenda item, I will provide an update on our portfolio transformation, which is well underway as we continue to move towards a high-growth, high-margin business.

But first, I'll turn it over to, Joe, to review our third quarter results in more detail.

Joseph T. Liotine

President & Chief Operating Officer, Whirlpool Corp.

Thanks, Marc. Turning to slide 5. Our performance this quarter was impacted by significant industry declines and elevated cost inflation that is now leveling off. In key countries across the globe, we saw double-digit demand declines. In response, we aggressively reduced our inventories by \$300 million, compared to the second quarter with a 35% reduction in global production.

Needless to say that this volume deleveraging impacted our Q3 results negatively. We do consider our inventories to now be very well balanced. We delivered ongoing EPS of \$4.49 and ongoing EBIT margin of 5.5%, with approximately 10% EBIT margins in North America. While these results are below our expectations, we remain confident that we have the right strategy and actions in place and are well positioned to deliver strong performance and shareholder returns.

Now, turning to slide 6. I will give more context on the magnitude of the industry decline by country. Across our key marketplaces, we faced market contractions of 10% to 25% during the quarter and expect similar declines in most countries as we move through the fourth quarter. In the US and throughout the world, consumer sentiment has been impacted by inflation and increasing interest rates. And the ongoing war in Ukraine and weakening currencies have further weighed on demand.

Turning to slide 7, you will see the impact of proactive steps taken to reduce inventories. We lowered our inventory by \$300 million from Q2 levels despite the significantly reduced shipment volumes within the quarter. In total, we reduced production volumes 35% in the quarter. To put this in context, this is pretty much the same level of production as Q2 2020, when we were faced with global COVID shutdowns. Even though painful within the quarter, we are now much better positioned to manage near-term demand fluctuations.

Turning to slide 8, in addition to managing our inventories, in response to industry decline, we are also experiencing elevated and persistent levels of inflation. Over the last two years, we've absorbed \$2.7 billion of inflation across our entire value chain, thus increasing our cost of goods sold by well over 10%. We experienced increases in raw materials, freight and logistics costs and more recently, energy costs. Aligning inventories with softer market demand was also a factor contributing to our performance. As expected, inflation peaked in the quarter and will remain elevated. We do expect cost inflation to persist throughout the first half of 2023 and costs moderating in the second half of 2023. Despite historically high inflation and market headwinds across the globe, Whirlpool remains well positioned to capitalize when the macroeconomic environment normalizes.

Turning to slide 9, we show the drivers of our third quarter EBIT margin. We continue to deliver strong price/mix of 550 basis points with previously announced cost-based price increases and slightly increased promotional activities that will continue into the fourth quarter. We responded to accelerated industry declines, and we are prepared for the upcoming holiday season. While we successfully reduced inventory, the associated volume deleveraging alongside continued elevated logistics and energy costs drove a 325 basis point impact in net cost. Raw material inflation was as expected and negatively impacted margins by 750 basis points, and we begin to see cost actions gaining traction with reduced marketing and technology spending, which was more than offset by the impact of foreign currency as the US dollar strengthened during the quarter. Overall, we delivered an ongoing EBIT margin of 5.5%.

Turning to slide 10. I'll review results for our North American region. As we continue to optimize our supply network, improving availability, we saw slight sequential share gains in the quarter. However, our revenues were down 8%, driven by weaker demand. We did aggressively reduce production levels to rebalance our inventory levels. This temporary volume deleveraging and related operating inefficiencies, in addition to continued inflationary pressures negatively impacted our margins for the quarter. Even with these challenges, the region delivered approximately 10% margins. Looking forward, we are excited about the unique opportunity to add InSinkErator to our portfolio of leading brands, and expect the transaction to close on October 31. And this acquisition is a clear accelerator of our ongoing portfolio transformation and delivering on our commitment of investing in high-growth, high-margin businesses. We continue to remain confident in the strength of our North American business.

Turning to slide 11. I'll review results for our Europe, Middle East and Africa region. As part of our portfolio transformation, we completed the sale of our Whirlpool Russia business on August 31. Revenue was negatively impacted by 11 points of foreign currency. Excluding Russia and the impact of foreign currency, revenue was down approximately 8%. The region's cost-based pricing actions were more than offset by lower volumes and cost inflation as consumer sentiment continues to be impacted by the war in Ukraine and inflation, resulting in a negative EBIT margin of 3.1%. Marc will provide an update on the strategic review of our EMEA business later in the call.

Turning to slide 12, I'll review results for our Latin America region. The region saw significant demand declines and continued inflation, more than offsetting our cost-based pricing and cost actions. Despite these negative impacts, the region delivered more than 5% EBIT.

Turning to slide 13, I'll review results for our Asia region. Excluding the impact of currency, revenue declined 1%. And cost-based pricing actions were more than offset by inflation, ultimately leading to an EBIT margin of slightly below 5%.

Now, I'll turn it over to Jim to discuss our full year 2022 guidance.

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

Thanks, Joe. Now turning to slide 14, I'll review our updated guidance for 2022. We expect to deliver fourth quarter EBIT similar to Q3. As a result, we have revised our full year ongoing EPS guidance to approximately \$19. We have reduced industry expectations for all regions, except Asia, reflecting the continuation of trends we experienced during the quarter. We now expect a revenue contraction of approximately 9% and ongoing EBIT margin of approximately 7.25% for the year, with North America margins of 12% plus for the full year. And we expect to generate free cash flow of approximately \$950 million or around 4.75% of net sales. While we have revised our guidance to reflect the current macro environment and expect many of these trends to continue through mid-2023, we remain committed to our long-term goals to drive profitable growth of 5% to 6%, ongoing EBIT margin expansion of 11% to 12% and cash conversion of 7% to 8% free cash flow.

Turning to slide 15, we will discuss the drivers of our 2022 free cash flow. We now expect to generate free cash flow of approximately \$950 million, compared to our previous guidance of \$1.25 billion. With cash earnings of approximately \$1.6 billion, we expect to continue to invest in our products and fund organic growth by unlocking capacity constraints and launching innovative products. These investments are in line with our target for capital expenditures of approximately 3% of net sales.

Additionally, we lowered our working capital expectations, reflecting the previously discussed inventory reduction actions. Lastly, our expectation remains unchanged as we anticipate minimal cash outlays related to restructuring as these actions have been largely completed.

Now I'll turn it over to Marc to provide our perspective beyond 2022.

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

Thanks, Jim. I want to spend a bit of time to demonstrate our strong track record of successfully operating for various economic cycles.

Turning to slide 17. You see that when faced with inflation across the board from materials to logistics and energy, we have responded early and decisively with cost-based pricing actions. Our strong execution of seven cost-based pricing actions and smart value-creating promotional activity has driven positive price/mix in nearly every quarter since 2019. With broad-based cost-based pricing actions across the globe in nearly every product category and channel, we have delivered a cumulative price/mix impact of 13%.

Turning to slide 18, I will discuss our significantly reduced fixed cost base. This chart shows the total of our SG&A factory and logistic costs over the past six years. Despite the inflation, which we also experienced in parts of our fixed costs, such as logistics or salaries, we've been able to reduce the fixed cost by approximately \$700 million or around 3% net reduction every year. In response to the current macroeconomic challenges, we have initiated an over \$500 million cost takeout program that will further reduce our fixed and variable costs in 2023.

As a result of these actions, we have drastically reduced our breakeven point, which will benefit us once industry volumes recover from current temporary weakness. It is an important step in structurally improving our long-term margins. As mentioned before, Whirlpool has a history of proactively responding to challenges we are facing, in particular, during these past years. And we've been [ph] usually (00:14:47) successful in managing through the headwinds over the past years as evidenced by the financial results as shown on slide 19.

Our multiyear financial performance shows our structurally improved business with expanding EBIT margins, significant EPS growth and strong ROIC. Our ongoing EBIT margin has improved with a compound annual growth rate over 4% and our ongoing earnings per share with a compound annual growth rate of approximately 13%, alongside strong returns on invested capital with a six points improvement since 2010.

Now turning to slide 21. I want to address how we are well-positioned to benefit from long-term demand tailwinds. While we are experiencing short-term demand softness, we're at the same time, very optimistic about the mid and long-term demand trends, in particular in North America.

Let me start by giving you a more detailed perspective on the US appliance demand. As discussed in previous earnings calls, it has two fundamental components, replacement demand, which currently represents 55% of our total market and the discretionary demand. With the trough of 2008 to 2011 replacement cycle now behind us, replacement demand has been very stable and even growing. And we do expect further momentum on the replacement side of the demand due to a significantly increased appliance usage over past years, as evidenced in the data, which we see from our connected appliances. What has still not fully recovered from a great recession in 2008 is the discretionary demand side, which ultimately is driven by the housing market.

Moving to slide 22. You can clearly see the strong connection between existing home sales and overall appliance demand. Existing home sales were slowly recovering from a great recession, but still haven't reached pre-recession levels. At the same time, overall appliance demand is also slowly recovering to essentially pre-recession levels.

Turning to slide 23, we show the same data in a bit of a more granular view, as well as our prediction over the next two years. Obviously, existing home sales declined sharply in 2022, reflecting the mortgage rate shock, keeping both new buyers away from the market as well as keeping prospective sellers from selling due to existing fixed mortgage rates, which are significantly lower than current mortgage rates. However, that doesn't change the fact that there's compounded pent-up demand for millennials as they reach prime homebuying years. We do expect home price appreciation to slow down and housing inventory to slowly improve to more historic levels. And ultimately, existing home sales [ph] returning (00:17:32) back to historical averages of above 6 million units per year.

Now turning to slide 24. I will share my perspective on new housing in the US and its impact on Whirlpool. New housing contributes approximately 15% of appliance demand in US. New housing construction has significantly lagged historical averages for more than a decade. For perspective, consider this from 1968 to 2008, a 40-year span, there was only one year in which fewer than 1.2 million new housing inventory were build. But much of a period between 2010 and 2017 was below this level, leading to the oldest US housing stock in the country's history. In total, we estimate an undersupply of housing of approximately 3 million to 4 million units. While we do not expect new housing to reach what we call steady-state supply of 1.7 million to 1.9 million units in 2022 or 2023, we do expect 2024 to show meaningful progress towards this level.

Turning to slide 25. I will share some perspective of our major appliance business outside of the US. We expect to win the Americas and accelerate our growth in India. India, in particular, has a very long runway for growth due to

favorable demographics and a still very low client penetration rate. We also fully expect to capture replacement demand with our strong share positions in Canada, Brazil and Mexico. And in India, we recently expanded our offering with a majority stake in Elica of India in 2021, and we just started the production of front load washers in India, and we want to continue to invest in this business. Combined with the best portfolio of brands, including Consul and Brastemp, each generating \$1 billion in sales in Brazil, we are well positioned outside the US.

Let me now move onto our last agenda item and discuss our progress on our portfolio transformation towards a higher margin and higher growth business. As you can see on slide 27, these efforts have been underway for some time. Since 2018, we have executed multiple steps to streamline and optimize our portfolio and are excited to add the InSinkErator business to our portfolio.

On slide 28, I will remind you of the three strong pillars that will accelerate our portfolio transformation towards a higher margin and higher growth business. Our global small appliance business and our commercial appliance business, both delivered strong margins of over 15%. And with the addition of InSinkErator, we have taken yet another significant step and strengthened our major appliance business, specifically in North America, bringing an iconic brand to Whirlpool. One that is the largest manufacturer of food waste disposers and instant hot water dispensers with more than 70% of the US industry, adding approximately \$1.25 EPS accretion in 2023. As Joe mentioned, we expect the acquisition to close on October 31. We expect to continue to invest in building Whirlpool as a higher growth and higher margin business, as we continue to deliver significant shareholder returns.

Now, turning to slide 29, I will provide an update on the strategic review of our EMEA business. We have been assessing a number of options for our business to a goal of maximizing long-term value. We have two guiding principles as we navigate this review. One, what creates the most value for Whirlpool Corporation; two, what is required for future success in Europe. We received significant interest from a number of parties and narrowed the discussions to the final negotiations with two strategic investors. Given the confidential nature of these discussions, we are unable to share further details, but will provide an update no later than on our fourth quarter earnings call. Again, our focus is to ensure we have the strongest business for our shareholders and employees, further supporting our portfolio transformation towards a high-growth and high-margin business.

In parallel with reviewing external options, we also revisited our internal continuation plan. We have completed a pressure test of all our business segments and evaluated strategic alternatives. Additionally, we have worked diligently to develop a sustainable and attractive business case [ph] for our (00:21:48) region. Ultimately, this will serve as a comparison and alternative path to any external option.

Now, let me close with a few remarks and turn to slide 30. We have a proven track record of successfully operating through cycles. And despite the significant industry headwinds we're facing, we still expect 2022 to be the second best year in our 111-year history. We have the right strategy and actions in place to navigate the current environment. With largely offset raw material inflation with decisive pricing actions, we have initiated cost actions which will deliver \$500 million of benefit in 2023 and adjusted inventories to reflect the current demand. We are reiterating our long-term growth outlook, and based on the initiatives we are taking, we believe that Whirlpool will exit the current and temporary [ph] industry low (00:22:40) and high operating margin. At the same time, we continue to advance our portfolio transformation, leaving us well positioned to continue to deliver strong shareholder value.

Now, we will end our formal remarks and open it up for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Sam Darkatsh from Raymond James. Your line is open.

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Q

Good morning, Marc, Jim, Joe, how are you?

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

Good morning, Sam.

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

A

Good morning.

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Q

Good morning. Thank you. I have couple of questions. The first around raws and the second around production. I mean, I guess the – I was originally going to ask you why the spread of possible raw material inflation in the fourth quarter was so wide, but I'm guessing that's mostly a function of you're not entirely sure yet what demand and production might look like. And so, I'm really more interested in your 2023 thoughts. I think in your prepared remarks, you mentioned that the first half of 2023, you might see raw material inflate year-on-year. And I'm confused as to why that might be given the steel contract resets and what have you. So, could you give some more quantification or clarification in terms of what you're expecting for raws next year?

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

So, Sam, it's Marc. Let me maybe first talk about the raw materials, and then I will have, Joe, commenting on production reductions and how we feel about the inventories. So, first of all, on raw material, you obviously saw that was still quite a bit of an element in Q3 of 7.5% impact on the EBIT margin, obviously, [indiscernible] (00:24:35) more. And that has, as we indicated, we expected that, that is pretty much peaked in Q3. However, Q4 not being materially better.

So, let me first talk about Q4. Part of the reason is – and there's two reasons why it's not materially better. One is spot prices have not come down a whole lot yet, but I emphasize yet. The second part is keep in mind big parts of our raw materials are on the hedging contracts or similar contracts, in particular steel and plastics.

So, [ph] even though with (00:25:07) spot prices start moving in the right direction, the impact you see on the contractual terms are not yet fully visible, but they will at one point. So to really clarify, and I'm glad you're raising it, on the first half, we're not saying it's increasing, we say it starts to ease. So, we do expect raw materials to come down and starting coming down throughout the first half. But I don't think you will see a dramatic change kind of year-over-year, and I think you'll see much more favorable comparison [ph] to (00:25:36) the back half. But

we do absolutely see an easing of raw material in the first half, and we will give you much more detail [ph] then (00:25:44) in our January earnings call around raw materials. Joe, on production.

Joseph T. Liotine

President & Chief Operating Officer, Whirlpool Corp.

A

Yes. Thanks, Marc. This is Joe. Related to production, we did see the industry a little bit softer than we had anticipated. So, we made very decisive actions to rightsize our production and ultimately our inventory to ensure we were in sync with where we saw the market developing. We expect that kind of continue into Q4. And so, we took those actions in a short manner to make sure that we were rightsized and then ready for upcoming Q4 holiday promotions and the demand that we saw ahead of us. Those actions were very pronounced, 35% reduction in production globally. So, as indicated in the prepared remarks, that's a level that we've not seen historically. The other parallel would be early on in COVID, we took a similar amount of production out just given all the things happening. So, very pronounced, very decisive, but it got us to a nice balanced position than we think going forward. But [ph] it responds (00:26:42) to where we're going to be with the market.

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Q

Joe, why would you ramp production back up in the fourth quarter, at least I think that's what you're anticipating, based on demand still being weak and the need to retain as much price as you can in 2023 once raws come off. I'm confused as to why you just took one big bite out of the apple as opposed to keeping production really modest until you start to see stabilizing trends.

Joseph T. Liotine

President & Chief Operating Officer, Whirlpool Corp.

A

Yes. Maybe that wasn't clear, Sam, but the intent was we rightsized in the quarter given the environment we're in, which is slightly worse than we anticipated from an industry standpoint, that got us to the right level. So, from here on out, we'll essentially be more in sync in managing production with output as is more typical. And so, there isn't an assumption of a big ramp down or a big ramp-up. That wasn't the implication. It was more about adjusting and synchronizing in Q3. And then now it's in sync with our expectations for Q4.

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

Or Sam, put it differently – it's Marc. In Q3, we produced significantly less than we sold. And in Q4, that these numbers will be much more aligned. In North America, we'll pretty much sell what we produce and produce what we sell. So, now in absolute terms, that maybe in North America, slightly higher than Q3, but we will be very careful about not getting ahead of ourselves in production.

So frankly, the other reason why we decided to take a big step in Q3, and I'm glad it's behind us, [indiscernible] (00:28:15) impacts are not fully behind us. But if we're convinced that the peak cost inflation was in Q3, we just felt why would you want to produce full volumes when you think it's the higher cost base. So, we want to take the step now, and it's behind us from an operational perspective and that puts us in a very good position to deal with the next couple of quarters.

Joseph T. Liotine

President & Chief Operating Officer, Whirlpool Corp.

A

Maybe want to add, Marc. That's true also globally. So, that phenomenon [ph] though the (00:28:38) characteristics are slightly different, those themes are true globally, which is important given all the things that we've experienced.

Operator: Your next question comes from the line of Eric Bosshard from Cleveland Research. Your line is open.

Eric Bosshard

Analyst, Cleveland Research Co. LLC

Q

Thank you. Two things, if I could. First of all, the price/mix realization in the quarter was, I think, 200 basis points different than you expected 90 days ago. What changed to influence that different result?

Joseph T. Liotine

President & Chief Operating Officer, Whirlpool Corp.

A

This is Joe. Really, the price/mix – I mean, we did get a better availability position. And as a consequence, we were able to go to market in ways that we thought were productive. Now that go-to-market action was slightly more intensive or elevated than we anticipated originally, and that was a function of a couple of things: us being in a better position from an availability standpoint and us seeing opportunities in the market. As a consequence, those are productive. And in North America, specifically, we were able to gain shares slightly from Q2 to Q3 as a consequence of both availability and our go-to-market approach.

Eric Bosshard

Analyst, Cleveland Research Co. LLC

Q

Okay. That makes sense. I understand the availability. Can you just – can you expand on the go-to-market approach? And I guess specifically, what I'm trying to figure out, is this participating more in promotions? Is this you being less aggressive on price increases? Is this retailers pushing back on price increases? Is this consumers buying down in mix? Like something is different. I appreciate that the go-to-market availability was better. But can you just expand on that a little bit for us?

Joseph T. Liotine

President & Chief Operating Officer, Whirlpool Corp.

A

Yes. I mean there's obviously varying components in there. So, there isn't just one answer for all things. But what I would say is there was some promotion involvement that we thought was accretive. So, we participated there. There was also some launches. We had a new dishwasher launch that came out. And so, there were some investments behind some new innovations as well. But by and large, those were slightly different [ph] than the (00:30:36) constrained environment, where we didn't have either of those two assets available to us.

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

Eric, maybe just adding to this one. First of all, again, that's why we also included the slides about the past price increases. We have now, in North America, but globally seven price increase behind us in a very short time period. So, we certainly haven't been shy of passing on costs to the marketplace. What happened in Q3 and more specifically to your question, yes, the market is slightly more promotional than, for example, a year ago or half year ago. I also want to point out it's not comparable to pre-COVID periods.

So, it is more promotional and more promotionally elevated and that's what we probably expect to see also go forward. But it's – you can't compare it to pre-COVID time. So, it's somewhere in between and that's what we're

just dealing right now with. [ph] Until those points (00:31:25) the good news is we start seeing sequential share gains for our North America business [ph] invested (00:31:29).

Operator: Your next question comes from the line of Susan Maklari from Goldman Sachs. Your line is open.

Susan Maklari

Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning everyone. My first question is...

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

Good morning, Susan.

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

A

Good morning.

Susan Maklari

Analyst, Goldman Sachs & Co. LLC

Q

Good morning. Can you talk a little bit about the channel inventories, appreciating that you took drastic steps to align your businesses. But what are you seeing out in the channels?

Joseph T. Liotine

President & Chief Operating Officer, Whirlpool Corp.

A

By and large – this is Joe again. By and large, what we're seeing is a fairly balanced perspective across all of our channels. We don't believe that we're undersupplied or oversupplied. And a lot of that has to do with the adjustments we've made throughout 2022, I would say. A few quarters back, we were still in constrained positions but we were undersupplied. That's no longer the case. We feel like we're right where we need to be holistically across the channels. And frankly, well positioned given we exited Q3 with all the adjustments that we made. So, I think that feels like a really good spot to be in and [ph] really wanted to end (00:32:30).

Susan Maklari

Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then perhaps taking a bit of a longer-term approach. Can you talk a little bit about how we think of the North American margin being at that 10% this quarter? Relative to that longer-term target that you've set for us in the mid-teens range, what are the steps that we'll need to see in order to get back there? And is that still the right range as you think about where the consumer and where the business is?

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

Susan, it's Marc, so maybe I can give a perspective. So, nothing has changed in our perspective about [ph] what should (00:33:04) be long-term structural margins in North America. And to be a little bit more specific, when we had the North America business on 17%, 18% margin, I mean, we felt that it's probably a little bit higher than we see the long-term structural margin by the same [indiscernible] (00:33:19) right now, the 10% are also not reflected of structural margins for two reasons. One is just – in the most simple way to explain it is kind of you

have two major macro cycles are out of sync right now, i.e., demand is down and cost is up. That is a typically cost follows demand.

Now if you look back the last 20 years, that happened a few times, but it typically doesn't last very long. So, to have these macro cycles out of sync to that extreme is highly unusual and will not last very long. And two, as Joe alluded to, the 35% production cut was also true for North America. So, we have a significant impact of – but you have a massive fixed cost business basically taking out that kind of volume that, of course, is you feel it. So, if you take these factors out of the equation, we're still coming back to these are the structural run rate margins which we communicated in the past, and we still absolutely feel they're achievable.

Now to your question about what needs to happen, the biggest [ph] step needs to (00:34:22) happen is the combination of external raw material costs coming down and us taking additional steps on our own cost takeout. These are the biggest, I would say, 0 to 12 months levers, which we have to pull and which we're committed to pull.

Operator: Your next question comes from the line of Mike Dahl from RBC Capital Markets. Your line is open.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Good morning. Thanks for taking my question. Marc, it's good to hear that InSinkErator's scheduled to close here just in the next couple of weeks. So, I was wondering if you could give us any insight on how is that business performing against this recent environment that you've seen in your core business? And how should we be thinking about the financial impacts that are embedded in guidance for the fourth quarter related to InSinkErator?

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

So, Mike, let me maybe try to give you first answer, but I would ask Jim to more – give you a little bit more financial perspective. So, first of all, we have not yet closed the transaction. That is expected to happen on October 31. Now obviously, we're very, very, very confident it will happen on that date and everything is on track.

And as such, we have – we're not yet controlling that business and as such, we cannot really fully communicate [ph] on this one (00:35:43). What we hear is the margins are intact, which is good, but we also see similar demand or discretionary demand started coming down. [ph] But by (00:35:54) nature, that business has a little bit longer order pipeline, et cetera. So, I would say, similar trends, similar actions, but the encouraging thing is the margins are very strong, [indiscernible] (00:36:06) very strong, and the market share is very strong. So – where everybody experiences the same element in housing and InSinkErator is not immune to that, but we strongly believe this is an extremely healthy, strong and sustainable business. And we're happy that we are hopefully – or well not hopefully, but we're going to be closing this transaction in 10 days from now.

Jim, if you want to make a comment [ph] a little bit (00:36:29) what we should expect for Q4 and going forward?

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

A

Yeah, Mike, this is Jim. I think last call, we disclosed that we see for 2023, the impact of the InSinkErator business being about \$1.25 per share. And so, if you think about that, the two months that we will then be consolidating within, the fourth quarter here would imply right around \$0.20, but then also you do – will have some effects that are related to just some of the – how you account for an acquisition at the very beginning and a few things that

you may have to adjust for. So, that's probably the maximum amount you'd see. So, it's going to be a pretty immaterial impact to the fourth quarter. And the bigger impact will be next year on a full year consolidated basis.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Got it. That's helpful. Thank you. And then my follow-up, it's somewhat related, but just given these – given the pressures you're seeing, you've taken down your free cash flow guidance. You have – you are increasing your leverage to take on InSinkEerator. Now you've got a lower free cash flow guide. It sounds like at least through the first half of next year, you're still expecting some market pressures, some inflation pressures. So, perhaps some further headwinds to free cash. How should we think about the implications, vis-à-vis, plans for deleveraging? How much net leverage you can kind of pay down post closing of the deal and then what that means for your buyback? I know it's on pause, but just any thoughts around kind of timing of how you're thinking about that.

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

A

Yeah, Mike, this is Jim again. And I think if you remember when we talked about as we look at how we'll finance the transaction is we'll use approximately \$500 million of existing cash on hand. And then through multiple term loans, we will finance another \$2.5 billion, which will put us about next year, let's just say, on a gross debt to leverage perspective around in the neighborhood of 3.5%. As you mentioned, right now we have suspended our buybacks. And we will be holding off on that until we begin to reduce our debt levels down, obviously, and that's what we said is going to be a focus going forward. But when you look at the structural cash flows of our business, which, as Marc alluded to before, haven't changed, and are just being impacted right now by a lower level of demand. But if that begins to come back, we expect our cash flows to come back to the levels we've seen in recent years that were above \$1 billion per year which will give us the ability to finance all of our different capital allocation priorities.

So obviously, continue to fund our business, pay our dividend and bring our debt levels down. And then at some point in the future, once we get back to our targeted leverage areas, then obviously, share buyback will become a priority that we will focus more on then. I have to remind folks that if you look at the last two years leading up to this, our return to shareholders was over \$2.5 billion when you look at share buybacks and dividends. So, it's obviously been a focus of ours. We will continue to have that as a focus in the future.

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

Mike, maybe just adding to this one. We pride ourselves – we have a very strong balance sheet, and we'll have a very strong balance sheet after the InSinkEerator acquisition. And that strong balance sheet gives us optionality. Just to give you two more additional comments. First of all, when we're referring to leverage, keep in mind, we were referring to gross debt leverage, which is from – by year-end, expect to be somewhere north of [ph] 3 (00:40:11). Keep in mind that excludes the almost \$2 billion cash, which we have right now, so that's a gross debt leverage.

And the other way to look at our financial structure and debt structure, we basically had, over the last couple of years, a long-term debt level of about \$5 billion. That is unchanged. What has changed is a little bit how we, over the last five years, refinance and did the debt [ph] letters (00:40:33). So, the debt [ph] letters (00:40:34) is very good, very long. The average cost – interest cost of these [ph] \$5 billion (00:40:38) is 2.9%. So, extremely attractive in today's terms.

What Jim was referring to is how we, in the short-term, finance the InSinkErator acquisition, where we made the decision we [ph] "will only use" (00:40:50) \$500 million of our cash and [indiscernible] (00:40:53) rest short-term loan, [ph] long-term (00:40:55) loan, and we intend to pay that down pretty fast. And that then at the same time, maybe not entirely sequential, maybe to some extent, parallel, will then potentially open the space again for share buybacks.

Operator: Your next question comes from the line of Mike Rehaut from JPMorgan. Your line is open.

Michael Rehaut

Analyst, JPMorgan Securities LLC

Thanks. Good morning, everyone.

Q

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

Good morning, Michael.

A

Michael Rehaut

Analyst, JPMorgan Securities LLC

First question, just wanted to get a little clarity on 3Q and 4Q and some of the puts and takes. Obviously, you highlighted the 35% reduction in global production – and I was wondering how much of that specifically impacted your margins? And if you have the absence of that headwind in 4Q, why would you have kind of similar margins? I don't know if there's a further moderation in price/mix. You kind of [indiscernible] (00:41:51) mentioned promotions starting to kick-up again. Any clarity around the impact of, again, inventory reductions in 3Q and why wouldn't it be a little better in 4Q?

Q

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

Hey, Michael, this is Jim. And let me kind of start with that. And so, if you look at the 35% reduction we did in our production in the quarter, that cost us over \$100 million. When you just think about the leverage you get within your factories and Marc and Joe talked about the level of fixed costs we have there, that cost actually does get spread across Q3 and Q4, because some of that does get hung up in inventory during this time period, and so it flows out throughout both quarters.

A

Additionally, when you think about – we talked about earlier, the peak of raw materials coming around Q3, which means – and Marc mentioned this earlier, while we did reduce our inventory levels and that still the inventory that we have on hand right now is probably at a peak cost. So, as that begins to flow out, and you think about how that flows out in Q4, that also has an impact on the margin in Q3 and Q4. And that's why as we look at the rest of the year, we do believe it will be relatively flat. We aren't expecting a significant change in demand through those two quarters.

And then, the last piece is, just naturally the seasonality of our business and how the promotional environment works even when it's reduced. Q4 is your strongest or your highest amount of promotional spend within a year, no matter what the absolute amount is for the year. So, that's also why you've got that seasonality effect in Q4.

Michael Rehaut

Analyst, JPMorgan Securities LLC

Q

Okay. No. That's a helpful rundown. I appreciate that. Secondly, I think there's been – you kind of highlighted some key variables to think about for next year, and there's been a couple of questions. Just want to try and clarify a little bit across cost takeout, which is obviously can be a big margin benefit, but also raw materials and price/mix. Kind of talking about, obviously, the headwinds that you expect in the first half, but then it should turn to tailwinds in the second half, at least in terms of raw materials, I was hoping to get some of your early expectations at this point on a full year net basis, would you expect raw materials to be a headwind or a tailwind based on current prices in the market today in or in steel and resins, et cetera? And with the cost takeout program, should we be thinking that perhaps you're going to give some of that back to the consumer amid a still softer demand environment? And what does that mean in terms of price/mix being even potentially negative?

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

A

So, Michael, it's Marc. So, let me try to answer your question. First of all, I would say upfront. Even in normal times in the October call, we would be hesitant to give you a lot of perspective on 2023. And I think we would all agree, we're not exactly [ph] living in (00:45:07) normal time. So, any forecast for 2023, obviously, you need to take it with grain of salt.

So, let me just run it down for items where we don't want to or can't give you today specific answers [indiscernible] (00:45:20) get a little bit more color and perspective. So, the first one, going through P&L demand, and I would say and pricing, is right now too uncertain to forecast, the global demand, some elements driven in terms of consumer sentiment and ultimately also relating to what happens to mortgage rates, what happens to the war in Ukraine. So, there's a lot of macro factors, which if we like it or not, will weigh on short-term demand, doesn't change our long-term demand or mid-term demand outlook. But of course, there needs to be some macro concerns being reduced or eliminated before we see a significant pickup of consumer confidence.

So, that's probably the demand and correlated and are related to different pricing is the biggest uncertainty, and we will give you our perspective in January. If you want to get my personal perspective for Q3, Q4 and probably Q1, I think we would still see depressed and volatile demand environment. And afterwards, we've got to see.

Then on the cost side, the \$500 million net cost reduction I was referring to earlier, we can confirm that. And if you want [ph] to say so (00:46:28), you can include that in your spreadsheet because that's what you will also hear in January. The raw materials side, we have not quantified, but obviously, as you could see here from our comments, we do expect gradual easing of raw material side. And yes, on a full year base, we absolutely do expect this to become a [ph] positive (00:46:48) factor, i.e., no more increase, but rather a decrease of raw material, the magnitude of which we will clarify and quantify in January, but we do expect a reduction of raw material costs.

Operator: Your next question comes from the line of Ken Zener from KeyBanc Capital Markets. Your line is open.

Kenneth Zener

Analyst, KeyBanc Capital Markets, Inc.

Good morning everybody.

Q

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

Good morning, Ken.

A

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

Good morning, Ken.

A

Kenneth Zener

Analyst, KeyBanc Capital Markets, Inc.

Jim, I wonder if you could go back to this curtailment, just I think I'm getting confused a little bit. The – obviously, [indiscernible] (00:47:25) what are you – generally, what do you talk about in terms of unit leverage within your business? Outside it was kind of in that 15%, 20% range. And I think you just mentioned there was \$100 million headwind in the third quarter associated with the curtailment...

Q

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

Correct.

A

Kenneth Zener

Analyst, KeyBanc Capital Markets, Inc.

...in North America. Was that right?

Q

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

[indiscernible] (00:47:47)...

A

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

Well, Not in North America, but I said there was Ken, within – we see due to the reduction we did approximately a little bit more than \$100 million due to the product that will come through in Q3 and Q4 through our P&L.

A

Kenneth Zener

Analyst, KeyBanc Capital Markets, Inc.

Q3 and Q4. Okay. Then – and I think, Joe, you talked about in various words, gaining some share sequentially, productive share gains, i.e., higher volume associated with promotions, Marc, you said nothing like pre-COVID but still a kind of drag. And I think it's obviously – it's understandable everyone's trying to narrow in on the cost basis or where you are in terms of volume in the business, if we were to be, let's say, flat next year if the margins would get us back to that longer-term guidance just because this year is exiting at such a lower rate, right, bifurcated second half, first half.

Q

And I'm not sure, if any of us know exactly where the existing homes are going to go next year given where rates are right now. So, is there a way that you could kind of talk about isolate those margin drags associated with the production and the promotion level? Does that promotion obviously help increase your volume versus a more stable run rate? Does that make sense at all, gentlemen? It's such a big cut in the margins as we exit the year is my question.

James W. Peters

Chief Financial Officer & Executive Vice President, Whirlpool Corp.

A

And maybe, Ken, let me kind of start on a few of the points there, and then I'll ask Joe and Marc to. I think if you start to think about next year and the opportunities for cost reduction that will come possibly with at least a demand headwind, as Marc mentioned, in the first quarter or early in the year. As we come out of this year, what we'll start with a healthy level of inventory, which then allows us to run our factories in a very efficient way and allows us to, hopefully, as we look at the demand environment and stay in check with it, and Joe used the word synchronization earlier that we synchronize our production with the demand environment, it takes that volatility out, which has a cost and has an inefficiency to it.

So, as we look forward, I think what you saw was such a big reduction here that we talked about because the market and the demand did move very quickly. We've now adjusted to that level, and we believe we can keep our production at that level and then as demand would increase ramp it up appropriately. So, I think as you think about next year, you do get efficiencies and cost savings that are part of that broader \$500 million that Marc talked about. But that's just one of many components that would be in there.

Marc Robert Bitzer

Chairman & Chief Executive Officer, Whirlpool Corp.

Thank you, Jim. I think this was the last question, which we had on the call. So, let me maybe just quickly wrap up here. So, as you heard throughout the prepared remarks and also in the Q&A, we are dealing with the headwinds of what you've seen in recessionary demand environment and we're dealing with that proactively and decisively. We've done so and we will continue to do so. At the same time, we are not yet experiencing the tailwinds which comes with recession in the form of cost reduction. We will at one point and we have also announced that we'll take on top of the additional cost actions internally and how we will bring down fixed and variable costs.

Beyond the short-term recession environment, the tricky question is how we're positioned to post recession environment. And on that note, as you hopefully heard is we continue to be very upbeat about the mid and long-term demand trends, which [indiscernible] (00:51:44) significant opportunity for us with everything which we've done on reducing and lowering breakeven points, which everything we've done on product innovation branding, I think, we're very well-positioned for a post-recessionary environment, which at one point will come.

So with that in mind, I thank you all for joining us today, and wish you a wonderful Friday. Thank you.

Operator: Ladies and gentlemen, that concludes today's conference call. You may now disconnect.

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